

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

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**United States Court of Appeals
FOR THE SECOND CIRCUIT**

**Docket Nos. 77-4028
78-4047**

**ITT WORLD COMMUNICATIONS INC. and
RCA GLOBAL COMMUNICATIONS, INC.,** *Petitioners,*

—against—

**FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,** *Respondents,*

**GRAPHNET SYSTEMS, INC., TELENET COMMUNICATIONS
CORP., WESTERN UNION INTERNATIONAL, INC., and
TRT TELECOMMUNICATIONS CORP.,** *Intervenors.*

ON PETITIONS FOR REVIEW OF A MEMORANDUM OPINION, ORDER, AUTHORIZATION AND CERTIFICATE OF THE FEDERAL COMMUNICATIONS COMMISSION

**BRIEF FOR PETITIONER
ITT WORLD COMMUNICATIONS INC.**

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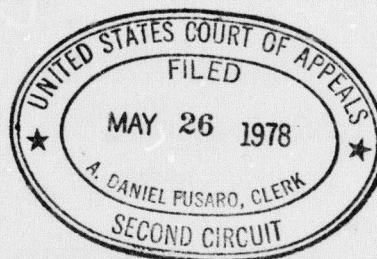


TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES.....	ii
ISSUE PRESENTED FOR REVIEW.....	2
STATEMENT OF THE CASE.....	3
A. The Structure of the International Record Communications Industry.....	3
1. Section 222 of the Communications Act and the Confinement of the IRCs to the "Gateway" Cities.....	4
2. The FCC's Refusal to Permit the Inter- national Carriers to Expand Their Services Beyond the Gateways.....	7
B. Graphnet and Telenet, and the FCC's Domestic Specialized Common Carrier Policies.....	11
C. The FCC's Previous Efforts to Reconcile its "Open Entry" Policies for Domestic Specialized Carriers With its Refusal to Expand the IRCs' Gateways....	13
D. The Proceedings Below.....	16
ARGUMENT: The FCC's Decision to Permit Graphnet and Telenet to Compete with the IRCs, Without Subjecting Them to the Same Competitive Restrictions as the Present International Carriers, is an Arbitrary and Capricious Discrimination Which Has Not Been Adequately Justified By the Commission.....	26
A. The FCC's Argument That Section 222 Requires the Commission to Treat the IRCs Differently From Graphnet and Telenet Rests on a Plainly Erroneous Interpretation of That Statute.....	31
B. The FCC May Not Properly Justify Its Unequal Treatment of the IRCs By Relying Upon the Purported Necessity of Protecting Graphnet and Telenet From Competition.....	41

CONCLUSION.....	44
Statutory Appendix	

TABLE OF AUTHORITIES

	<u>Page</u>
A. Judicial Decisions	
<u>American Ship Building Co. v. N.L.R.B.</u> , 380 U.S. 300 (1965).....	32
<u>Cass v. United States</u> , 417 U.S. 72 (1974).....	35
<u>Distrigas of Massachusetts Corporation v.</u> <u>F.P.C.</u> , 517 F.2d 761 (1st Cir. 1975).....	27
<u>Ernst & Ernst v. Hochfelder</u> , 425 U.S. 185 (1976).....	34
<u>F.C.C. v. RCA Communications, Inc.</u> , 346 U.S. 86 (1953).....	18
<u>F.T.C. v. Colgate Palmolive Co.</u> , 380 U.S. 374 (1965).....	32
<u>F.T.C. v. Crowther</u> , 430 F.2d 510 (D.C. Cir. 1970)..	30
<u>Fishgold & Sullivan Drydock & Repair Corp.</u> , 154 F.2d 785 (2nd Cir. 1946), <u>aff'd.</u> , 328 U.S. 275 (1946).....	32
<u>Greater Boston Television Corp. v. F.C.C.</u> , 444 F.2d 841 (D.C. Cir. 1971), <u>cert. den.</u> , 403 U.S. 923 (1971).....	30
<u>Hawaiian Telephone Company v. F.C.C.</u> , 498 F.2d 771 (D.C. Cir. 1974).....	42-44
<u>Kodiak Airways, Inc. v. C.A.B.</u> , 447 F.2d 341 (D.C. Cir. 1971).....	30
<u>Kokoszka v. Belford</u> , 417 U.S. 642 (1974).....	35
<u>Larus & Brother Co., Inc. v. F.C.C.</u> , 447 F.2d 876 (D.C. Cir. 1971).....	30

<u>Local 814, I.B.T.C.W. v. N.L.R.B.</u> , 512 F.2d 564 (D.C. Cir. 1975).....	27
<u>Marco Sales Co. v. F.T.C.</u> , 453 F.2d 1 (2nd Cir. 1971).....	27, 28
<u>Marine Space Enclosures, Inc. v. F.M.C.</u> , 420 F.2d 577 (D.C. Cir. 1969).....	30
<u>Mariott In-Flite Services Div. of Mariott Corp. v. N.L.R.B.</u> , 417 F.2d 563 (4th Cir. 1969), <u>cert. den.</u> , 397 U.S. 920 (1970).....	27
<u>Mary Carter Paint Co. v. F.T.C.</u> , 333 F.2d 654 (5th Cir. 1964), <u>rev'd</u> 382 U.S. 46 (1965).....	27
<u>Melody Music Inc. v. F.C.C.</u> , 345 F.2d 730 (D.C. Cir. 1965).....	30
<u>N.L.R.B. v. Brown</u> , 380 U.S. 278 (1965).....	32
<u>N.L.R.B. v. Columbia University</u> , 541 F.2d 922 (2nd Cir. 1976).....	33
<u>N.L.R.B. v. Enterprise Ass'n. of Pipefitters, Local No. 638</u> , 429 U.S. 507 (1977).....	33
<u>National Woodwork Manufacturers Ass'n. v. N.L.R.B.</u> , 386 U.S. 612 (1967).....	35
<u>Packard Motor Car Co. v. N.L.R.B.</u> , 330 U.S. 485 (1947)..	34
<u>RCA Global Communications, Inc. v. F.C.C.</u> , 559 F.2d 881 (2nd Cir. 1977), <u>on reh'g.</u> , 563 F.2d 1 (2nd Cir. 1977), <u>opinion following remand</u> , __ F.2d_ (2nd Cir. 1978).....	5, 44
<u>Reliance Electric Co. v. Emerson Electric Co.</u> , 404 U.S. 418 (1972).....	37
<u>Secretary of Agriculture v. United States</u> , 347 U.S. 645 (1954).....	30
<u>S.E.C. v. Chenery Corp.</u> , 318 U.S. 80 (1943).....	33, 40
<u>Teamsters Local Union 769 v. N.L.R.B.</u> , 532 F.2d 1385 (D.C. Cir. 1976).....	27
<u>Tidewater Oil Co. v. United States</u> , 409 U.S. 151 (1972).....	35

<u>Train v. Colorado Public Interest Research Group</u> , 426 U.S. 1 (1976).....	35
<u>United Housing Foundation, Inc. v. Forman</u> , 421 U.S. 837 (1975).....	37
<u>United States v. American Trucking Associations, Inc.</u> , 310 U.S. 534 (1940).....	34, 35
<u>United States v. Bornstein</u> , 423 U.S. 303 (1976).....	35
<u>United States v. Oregon</u> , 366 U.S. 643 (1961).....	34
<u>Volkswagenwerk Aktiengesellschaft v. F.M.C.</u> , 390 U.S. 261 (1968).....	32
<u>Washington Utilities & Transportation Commission</u> <u>v. F.C.C.</u> , 513 F.2d 1142 (9th Cir. 1975), <u>cert.</u> <u>den.</u> , 423 U.S. 836 (1975).....	41
<u>Western Union International, Inc. v. F.C.C.</u> , 544 F.2d 87 (2nd Cir. 1976), <u>cert. den.</u> , _ U.S. _ (1977).....	5,6, 36,37
<u>Wisdom v. Norton</u> , 507 F.2d 750 (2nd Cir. 1974).....	32

B. Decisions of the Federal Communications Commission

<u>All American Cables and Radio, Inc.</u> , 15 F.C.C. 293.....	8
<u>American Telephone & Telegraph Co.</u> , 55 F.C.C. 2d 224 (1975).....	30
<u>Graphnet Systems, Inc.</u> , 44 F.C.C. 2d 800 (1974).....	13
<u>International Record Carriers' Communications</u> 38 F.C.C. 2d 543 (1972).....	9
40 F.C.C. 2d 1082 (1973).....	9
54 F.C.C. 2d 532 (1975).....	10, 38
54 F.C.C. 2d 909 (1975).....	7
58 F.C.C. 2d 250 (1976).....	8
<u>ITT Corporate Communications Services, Inc.</u> , _ F.C.C. 2d _ (F.C.C. 77-428, July 6, 1977).....	14
<u>ITT Domestic Transmission Systems, Inc.</u> , 62 F.C.C. 2d 236 (1976).....	14, 15
<u>Packet Communications, Inc.</u> , 43 F.C.C. 2d 922 (1973).....	12
<u>Press Wireless, Inc.</u> , 21 F.C.C. 311 (1956).....	8

<u>RCA Global Communications, Inc., et al., 56</u> <u>F.C.C. 2d 660 (1975)</u>	14, 15, 39
<u>Resale and Shared Use of Common Carrier Services,</u> <u>60 F.C.C. 2d 261 (1976), on reconsideration, 62</u> <u>F.C.C. 2d 588 (1977), aff'd., sub. nom. A.T.&T. v.</u> <u>F.C.C., 572 F.2d 17 (2nd Cir. 1978)</u>	13
<u>Specialized Common Carrier Services, 29 F.C.C. 2d</u> <u>870 (1971), reconsideration denied, 31 F.C.C. 2d 1106</u> <u>(1971), aff'd., sub. n. l., Washington U.&T. Com., v.</u> <u>F.C.C., 513 F.2d 1142 (9th Cir. 1975), cert. den., 423</u> <u>U.S. 836 (1975)</u>	11, 12, 30
<u>Telenet Communications Corp., 46 F.C.C. 2d 680</u> <u>(1974)</u>	13
<u>United States Transmission Systems, Inc., 48 F.C.C.</u> <u>2d 859 (1974), reconsideration denied, 51 F.C.C. 2d</u> <u>207 (1975), aff'd. sub. nom. A.T.&T. v. F.C.C., 539</u> <u>F.2d 767 (D.C. Cir. 1976)</u>	13, 15

C. Statutes

Administrative Procedure Act

Section 10(e), 5 U.S.C. §706 26

Communications Act of 1934, as amended, 47 U.S.C.
§§151 et seq.

Section 1, 47 U.S.C. §151..... 44

Section 222, 47 U.S.C. §222..... 4-9,
31-37, 40, 4

Section 222(a)(5), 47 U.S.C. §222(a)(5)..... 6, 34-38

Section 222(a)(6), 47 U.S.C. §222(a)(6)..... 6

Section 222(c)(2), 47 U.S.C. §222(c)(2)..... 5

Section 222(e)(1), 47 U.S.C. §222(e)(1)..... 5

D. Legislative History of Section 222 of the Communications Act

House Report 69, 78th Cong., 1st Sess. (1943)..... 36

House Report 142, 78th Cong., 1st Sess. (1943)..... 36

S. 2598, 77th Cong., 2d Sess. (1942)..... 36

Senate Report 1490, 77th Cong., 2d Se (1942)..... 36

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On Petitions for Review of a Memo-
randum Opinion, Order, Authoriza-
tion and Certificate of the Federal
Communications Commission

BRIEF FOR PETITIONER
ITT WORLD COMMUNICATIONS INC.

Petitioner ITT World Communications Inc. ("ITT
Worldcom") submits this brief in support of its petition for
review of a Memorandum Opinion, Order, Authorization and

Certificate (the "Order") of respondent Federal Communications Commission ("FCC" or the "Commission"), in which the Commission authorized intervenors Graphnet Systems, Inc. ("Graphnet") and Telenet Communications Corp. ("Telenet") to offer certain international communication services in competition with ITT Worldcom, petitioner RCA Global Communications, Inc. ("RCA Globcom") and the other existing international data/record carriers ("IRCs"). The FCC's Order is reported in 63 F.C.C. 2d at 402 (1977), and is reproduced in the Joint Appendix at pp. JA 1 - JA 13.*

On April 3, 1978, while ITT Worldcom's Petition for Review was pending before the Court, the FCC released a further Memorandum Opinion and Order, FCC 78-181 (the "Reconsideration Order") (JA 20 - JA 44), which denied RCA Globcom's petition for reconsideration and reaffirmed the FCC's original Order in all respects here relevant. RCA Globcom petitioned the Court for review of the Reconsideration Order, and its Petition for Review was consolidated with the Petition which had already been filed by ITT Worldcom.

ISSUE PRESENTED FOR REVIEW

Did the FCC act arbitrarily and capriciously, depart without adequate explanation from its prior policies, and

* Subsequent references in the form "JA" followed by a page number are to the Joint Appendix.

give Graphnet and Telenet an unfair and discriminatory competitive advantage, when it authorized Graphnet and Telenet to compete with the IRCs to offer international communication services without either (a) subjecting Graphnet and Telenet to the same restrictions which the Commission had applied to the IRCs or (b) modifying the restrictions which it had placed on the IRCs, so that the IRCs would have an equal opportunity to compete with the new carriers?

STATEMENT OF THE CASE

ITT Worldcom's Petition for Review presents the question of whether the FCC has arbitrarily and capriciously discriminated between two different groups of competitors by unfairly favoring Graphnet and Telenet over the IRCs. To establish a proper context for the issues raised on this appeal, it is necessary to review the background of the international telecommunications industry and the evolution of certain FCC policies which contributed to the FCC's Order.

A. The Structure of the International Record Communications Industry

ITT Worldcom, RCA Globcom and intervenors Western Union International, Inc. ("WUI") and TRT Telecommunications Corp. ("TRT") are the four principal IRCs.* The IRCs compete

* The smaller IRCs include FTC Communications Inc. and U.S. Liberia Radio Corp.

with one another to provide the public with a number of international "record", or data-related, communications services which include, in addition to traditional telegraph service, such more recent innovations as telex, alternate voice/data, data transmission, and facsimile services.

1. Section 222 of the Communications Act and the Confinement of the IRCs to the "Gateway" Cities

Although the IRCs' communication services link the United States with virtually every foreign country, the IRCs' activities within the United States have been confined to a limited number of "gateway" cities where the FCC has permitted them to operate.* The IRCs are dependent on various domestic carriers (principally the Western Union Telegraph Company) to deliver and originate international messages in the "hinterland" outside the IRCs' gateway cities.

The present structure of the IRCs' industry has its origins in Section 222 of the Communications Act, 47 U.S.C §222, which was adopted by Congress in 1943.** Section 222 was enacted to permit a merger between the Western Union Telegraph Company ("Western Union") and Postal Telegraph

* The IRCs are authorized to use New York, Washington, D.C., San Francisco, Miami and New Orleans as their domestic "gateway" cities.

** The relevant portions of Section 222 are reproduced in a statutory appendix to this brief.

Company ("Postal"), which in combination accounted for virtually all domestic telegraph traffic being handled at that time. Because Section 222 granted Western Union a de facto monopoly of domestic telegraph operations, Congress was concerned that Western Union would have an unfair advantage over the international carriers if it were permitted to provide international services itself while at the same time having exclusive control over the source for most of that traffic.* Accordingly, Section 222 prohibited Western Union from competing directly with the international carriers to offer

* The Western Union-Postal merger posed a serious competitive danger to the corporate predecessors of RCA Globcom and ITT Worldcom because those IRCs did not maintain extensive domestic networks, and were therefore dependent on the domestic carriers to originate or deliver international telegrams in most parts of the country. In contrast to the IRCs, Western Union operated both domestically and internationally at the time of its merger with Postal, and the merger therefore left the IRCs totally dependent on Western Union, their international competitor, for domestic services which were essential to their continued success. When Congress enacted Section 222, it attempted to preserve the competitive vitality of the independent IRCs in two ways. First, it required Western Union to divest itself of its international telegraph operations. Section 222(c)(2); 47 U.S.C. §222(c)(2). See, Western Union International, Inc. v. F.C.C., 544 F.2d 87 (2nd Cir. 1976), cert. den., ___ U.S. ___ (1977). Secondly, Congress provided for the development, under FCC supervision, of an "International Formula" for the division of international telegrams among Western Union and the IRCs in a manner which was "just, reasonable, equitable and in the public interest." Section 222(e)(1); 47 U.S.C. §222 (e)(1). See, RCA Global Communications, Inc. v. F.C.C., 559 F.2d 881 (2nd Cir. 1977), on reh'g., 563 F.2d 1 (2nd Cir. 1977), opinion following remand, ___ F.2d ___ (2nd Cir. April 18, 1978).

international record services. See, Western Union International, Inc. v. F.C.C., 544 F.2d 87 (2nd Cir. 1976), cert. den., ___ U.S. ___ (1977).

In order to delineate the areas of operations which would be open to Western Union after the merger, Section 222 distinguished between two broad categories of telegraph service:

(1) "Domestic telegraph operations," which Western Union would be permitted to continue after the merger, were defined in Section 222(a)(5) to include telegraph services provided within the continental United States (including Alaska) and between the United States and certain contiguous countries.

(2) "International telegraph operations," from which Western Union would be required to withdraw following the merger, were defined in Section 222(a)(6) to include telegraph services provided between the United States and foreign points.

Included within the definition of "Domestic telegraph operations" in Section 222(a)(5) is a provision which the FCC has interpreted to restrict the IRCs' operations within the United States to particular gateways approved by the FCC:

"Provided, that nothing in this section shall prevent international telegraph carriers from accepting and delivering international telegraph messages in the cities which constitute gateways approved by the Commission as points of entrance into or exit from the continental United States, under regulations prescribed by the Commission, and the incidental

transmission or reception of the same over its own or leased lines or circuits within the continental United States."

Although Section 222 refers expressly only to "telegraph" operations, "the Commission has traditionally applied the gateway concept to other services of the IRCs as well." International Record Carriers' Communications, 54 F.C.C. 2d 909, 920 (1975). Thus, under the FCC's interpretation of Section 222, the IRCs are not merely prevented from offering traditional forms of public telegraph service in the hinterland, but are also prohibited from offering any of their other data or "record" communications services (including the types of service at issue here) directly to customers located outside their present gateway cities, unless the FCC authorizes them to do so.*

2. The FCC's Refusal to Permit the International Carriers to Expand Their Services Beyond the Gateways.

From time to time one or another of the IRCs has sought permission either to increase the number of gateways or to expand the scope of its operations beyond the gateways, but the FCC has steadfastly declined to authorize any meaningful gateway expansion.**

* As is the case with telegraph service, the IRCs may reach potential "hinterland" customers for their other services only through interconnection with the facilities of one of the domestic carriers.

** The only significant deviations from the FCC's restrictive gateway policies are found in (a) its 1976 determination

[Footnote continued on next page]

As early as May of 1956, Press Wireless, Inc., an international carrier which subsequently merged with ITT Worldcom, filed an application with the Commission seeking authority to lease and operate temporary facilities between its operating center in the New York gateway and a temporary public office in Chicago to serve the Democratic National Convention of that year. In its Order denying that application,* the FCC concluded that it had appropriate authority, pursuant to Section 222, to grant the request of Press Wireless to provide service to a hinterland point, but declined to make such a grant upon the basis of protectionist policies for the benefit of the domestic carrier, Western Union.**

[Footnote continued from previous page]

to permit TRT to operate in the New York, Washington and San Francisco gateways of the larger IRCs, and to permit the other IRCs to use TRT's gateway cities, Miami and New Orleans, International Record Carriers' Communications, 58 F.C.C. 2d 250 (1976); and (b) its determination in 1950 to permit hinterland users to access directly an IRC if the user paid the charges for the domestic telex or telephone call from his location to the IRC's gateway--referred to as "paid direct access," All American Cables and Radio, Inc., 15 F.C.C. 293 (1950).

* Press Wireless, Inc., 21 F.C.C. 311 (1956).

** Western Union has opposed expansion of the IRCs' gateways because it presently receives a share of the revenue generated by each international message from the hinterland which it turns over to the IRCs. If the IRCs' hinterland operations were expanded, Western Union's income from this source would obviously decrease.

Near the end of 1972 several of the IRCs, including ITT Worldcom, submitted tariffs to the FCC under which they proposed to absorb the cost of a domestic telephone or telex communication to or from the hinterland for those customers which chose to deal directly with the IRCs. In its so-called "Free Direct Access" decision, the Commission rejected the IRCs' proposed tariffs, on the grounds that the service proposed therein would constitute an expansion of the IRCs' gateways, and that such an expansion could only be accomplished by the Commission's approval of applications from the IRCs for appropriate new gateway authority, pursuant to Section 222 of the Communications Act.*

In 1971 and early 1972, ITT Worldcom and RCA Globcom had in fact applied to the FCC for authority to expand their operations to a number of new gateway cities. Although the Commission initiated a general inquiry respecting the operations of the IRCs in December of 1972,** in which it acknowledged the pendency of the above described applications for expanded gateway authority, the Commission has never taken any action to address the merits of these applications.

* International Record Carriers' Communications, 40 F.C.C.2d 1082 (1973).

** International Record Carriers' Communications, FCC Docket No. 19660, 38 F.C.C.2d 543 (1972).

Three years later, in 1975, similar applications were filed on behalf of TRT and WUI, also seeking additional gateways. Presumably in response to these additional applications, the FCC released a Further Notice of Inquiry,* wherein it proposed to address all of the applications then pending for additional gateway authority and invited comments from interested parties on the question of whether it should adopt a policy favoring the authorization of additional gateways. However, in response to pleas for protection from Western Union, the Commission deferred indefinitely the date for the comments which had been requested by that Further Notice. Thus, in 1978, over six years following the initial filing of the applications for expanded gateway authorization, the Commission has not only failed to either grant or deny any

* International Record Carriers' Communications, 54 F.C.C.2d 532 (1975). It is noteworthy that in its Further Notice of Inquiry, which momentarily established a procedural framework for substantive comments respecting new hinterland gateways, the Commission stated that:

"It is our view that the public interest would be served by authorizing some new gateway cities under Section 222 of the Act. Since the existing gateways were approved some 30 or more years ago, there have been significant changes in the operations of the IRCs and technological advances in the provision of communications service which may have rendered obsolete a gateway framework suitable to another era." 54 F.C.C. 2d at 533.

However, as described above, the F.C.C. has yet to act on the IRCs' applications to expand their gateways, despite its view that such an expansion would serve the public interest.

of these applications, but has not even reached the point that it can address the policy implications raised by such applications.

B. Graphnet and Telenet, and the FCC's Domestic Specialized Common Carrier Policies

Graphnet and Telenet are two of a number of new domestic common carriers which have been authorized by the Commission in recent years pursuant to policies developed in its Specialized Common Carrier Services proceeding* and the subsequent orders which derive from that decision.

In its Specialized Carrier decision, the Commission announced the adoption of a policy "in favor of the entry of new carriers in the specialized communications field."** This policy was developed upon the basis of an extensive record which was subjected to a lengthy and thorough analysis by the Commission (indeed, the Commission's First Report and Order encompassed some 72 pages, excluding appendices). The issues in that proceeding were exclusively concerned with domestic communications needs and facilities, and the sole focus of the record in that proceeding was on these purely domestic issues. Further, the singular basis given by the Commission for the

* First Report and Order, 29 F.C.C. 2d 870 (1971), reconsideration denied, 31 F.C.C. 2d 1106 (1971), aff'd., sub nom. Washington U. & T. Com. v. F.C.C., 513 F.2d 1142 (9th Cir. 1975), cert. den., 423 U.S. 836 (1975).

** Id. at 920.

adoption of its "open entry" policy in that proceeding was its conclusion that a latent demand existed for the services which would be provided by the specialized carriers, a demand which American Telephone & Telegraph Company and Western Union, the monopoly domestic telephone and telegraph carriers, lacked the necessary motivation and flexibility to meet.*

After the issuance of the Specialized Carrier decision, a number of applications were filed for new domestic services by a class of would-be carriers which became known as "value-added" carriers. A value-added carrier is simply one which obtains an underlying communications facility from another common carrier and adds one or more service features to that facility. The combined underlying communications facility and added service feature[s] are then made available, pursuant to appropriate tariffs, to the customers of the value-added carrier. Although the possible authorization of such value-added carriers had not been specifically addressed by the Specialized Carrier decision, the Commission made clear in its grant of the application of the initial value-added applicant, Packet Communications Inc., that this genre of carriers fell within the scope of the open-entry philosophy expressed in the Specialized Carrier decision.** Following the Packet

* Id. at 906-910.

** Packet Communications Inc., 43 F.C.C.2d 922 (1973).

Communications decision, the Commission granted applications by Graphnet* and Telenet** to provide value-added services within the contiguous United States and the District of Columbia.***

C. The FCC's Previous Efforts to Reconcile its "Open Entry" Policies for Domestic Specialized Carriers With its Refusal to Expand the IRCs' Gateways

Among the companies which have sought to take advantage of the FCC's "open entry" policies for specialized domestic carriers are the corporate affiliates of ITT Worldcom and RCA Globcom. The FCC has granted authority to operate as specialized common carriers to United States Transmission Systems, Inc. ("USTS"),**** (a domestic private line carrier);

* Graphnet Systems, Inc., 44 F.C.C.2d 800 (1974).

** Telenet Communications Corporation, 46 F.C.C.2d 680 (1974).

*** In a 1976 decision, the Commission determined that tariff restrictions, on the part of common carriers providing "underlying" facilities, against the resale of such facilities by value-added carriers were unlawful. Resale and Shared Use of Common Carrier Services, 60 F.C.C.2d 261 (1976), aff'd., sub nom. AT&T v. F.C.C., 572 F.2d 17 (2nd Cir. 1978). In that decision, the Commission specifically addressed and reaffirmed its policy of open entry for the value-added or "resale" carriers. Id. at 308-310, 316. (The Commission now appears to prefer the term "resale" to the term "value-added" as the proper characterization for this group of carriers.) In a further Order on Reconsideration, the Commission determined that its resale policies "should not, at this time, be applied to international services." Resale and Shared Use of Common Carrier Services, 62 F.C.C. 2d 588, 593 (1977).

**** United States Transmission Systems, Inc., 48 F.C.C. 2d 859 (1974), reconsideration denied, 51 F.C.C. 2d 207 (1975), aff'd., A.T.&T. v. F.C.C., 539 F.2d 767 (D.C. Cir. 1976).

ITT Domestic Transmission Systems, Inc. ("ITTDTS")* (a domestic carrier, authorized to provide services competitive with those of Graphnet and Telenet); and ITT Corporate Communications Services, Inc., ("ITCCS")** (a domestic carrier providing private switching system services), all three of which are subsidiaries of ITT Worldcom's parent, the International Telephone and Telegraph Corporation. Similarly, FCC authorization has been granted to RCA American Communications, Inc. ("RCA Americom")*** (a domestic communications satellite carrier) and RCA Globcom Systems, Inc. ("RCA Systems")**** (a domestic communications network management service), each of which is a subsidiary of RCA Globcom's parent corporation.

In authorizing the entry of the IRCs' corporate affiliates into the domestic market, the FCC seemingly perceived an inconsistency between its policy of authorizing "open entry" for domestic specialized common carriers, and its policy of rigidly restricting the IRCs' operations to the gateway cities. If the IRCs interconnected their communications

* ITT Domestic Transmission Systems, Inc., 62 F.C.C. 2d 236 (1976). Reconsideration Pending.

** Memorandum Opinion and Order, released July 6, 1977, FCC File No. W-P-C-900 (FCC 77-428), ___ F.C.C.2d ___.

*** RCA Global Communications, Inc., et al., 56 F.C.C.2d 660 (1975).

**** Memorandum Opinion, Order and Certificate, released April 18, 1978, FCC File No. W-P-C-1396 ___ F.C.C.2d ___.

facilities with those of their new corporate affiliates, the FCC stated, the IRCs would have extended their domestic activities beyond the gateway cities. In an attempt to resolve this conflict between its two policies, the FCC chose to extend its restrictive gateway policy to the point of denying the IRCs the right to interconnect with affiliated, but operationally separate, domestic companies, on the ground that such an interconnection would result in an expansion of the IRCs' gateways. Thus, ITT Worldcom has been prohibited by the Commission from interconnection with USTS, ITTDTS, or ITTCCS, and RCA Globcom has been prohibited from interconnecting with RCA Americom or RCA Systems.*

As will be demonstrated more fully below, the principal error in the FCC's Order is that when the FCC decided to permit Telenet and Graphnet to expand their operations into the international market, the FCC failed to place any similar restrictions on interconnection between those carriers' domestic and international facilities, or to restrict their

* See USTS, supra, 48 F.C.C.2d at 862; RCA Global Communications, supra, 56 F.C.C.2d at 672; ITTDTS, supra, 62 F.C.C.2d at 242-43. Although these restrictions, which were first imposed in 1974, were stated by the FCC to be temporary and were allegedly intended only to remain in effect until such time as the FCC completed its overall gateway inquiry, in FCC Docket No. 19660 (which was begun in 1972), the FCC has, to this date, taken no further action toward reaching a disposition of that overall gateway inquiry or toward the elimination of these interconnection restrictions.

international activities to the gateway cities, thereby giving them an arbitrary and unfair competitive advantage over the IRCs.

D. The Proceedings Below

The instant proceeding commenced in February 1976, when Graphnet filed an application with the FCC to provide its then-authorized domestic services to various points in Europe. (JA 45) In May 1976 Telenet filed an application similarly seeking authority to extend its domestic services to the United Kingdom and, by connection through the U.K., to other points in Europe. (JA 76) The FCC consolidated these applications for consideration along with an application filed in October of 1976 by RCA Globcom (JA 480), and an application filed in November of 1976 by WUI (JA 507),* all of which

* Though not included in the FCC order under review here, ITT Worldcom filed its own application for an international data transfer service on January 6, 1977, after obtaining an operating agreement from its overseas correspondent. ITT Worldcom's application was granted on April 5, 1977. The IRCs' filings were subsequent to those of Graphnet and Telenet because, consistent with the FCC's existing practices, the IRCs had negotiated the necessary operating arrangements with the appropriate foreign telecommunications authorities before seeking permission from the Commission to offer the service in question. As is more fully explained, *infra*, p. 17, n.***, the FCC's Order departed from this prior practice when it accepted for filing, and then granted, the Telenet and Graphnet applications even though those carriers had not first obtained operating agreements from the appropriate foreign authorities.

applications the FCC characterized as seeking "to provide a form of enhanced data communications service between the United States and various overseas points." (JA 2)*

Pleadings in opposition to the Graphnet and Telenet applications were filed by all of the four IRCs which are parties to the review proceeding in this Court.** In their opposing comments, the IRCs first pointed out that neither Graphnet nor Telenet had yet obtained the operating agreements with foreign telecommunications administrations which were necessary to extend their domestic services to overseas points, and that under the FCC's usual administrative practice, their applications should therefore have been rejected as unripe for the Commission's consideration.***

* Graphnet's principal service is a facsimile transmission service which, from the user's standpoint, is substantially identical to the message telegraph services of the IRCs. Telenet's primary service offering is a data transfer service which is similar to the message telegraph and telex services of the IRCs and is basically identical to data transmission services inaugurated by the IRCs in late 1976 and early 1977. In addition, Telenet and Graphnet were recently authorized by the FCC to provide communications services between digital terminal devices, a service that is comparable to telex service, which is the predominant service provided by the IRCs.

** These opposing pleadings are reproduced in the Joint Appendix at JA 212, 245 (ITT Worldcom); JA 196, 207, 260 (RCA Globcom); JA 220, 253 (WUI); JA 230, 251 (TRT).

*** In order to render their international services to overseas customers, all international carriers must

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With regard to the merits of the Graphnet and Telenet applications, the IRCs argued that, for a number of reasons which ITT Worldcom does not raise on this appeal, the public interest would best be served if the FCC denied the Graphnet and Telenet applications, and permitted the IRCs (interconnecting with domestic carriers, if necessary) to offer the new international services which all the applicants sought to provide.*

[Footnote continued from previous page]

connect their circuits with those of the appropriate foreign telecommunications carrier or administration. Since the character and cost of the services which the international carrier can provide depend, to a considerable extent, on the terms of the "operating agreement" which the carrier negotiates with the foreign administration, the FCC has traditionally taken the position that it cannot properly evaluate proposals for new international services until such operating agreements have been concluded. The Commission has therefore refused to consider applications which were filed without operating arrangements. As noted previously, the IRCs, unlike Graphnet and Telenet, obtained the appropriate operating agreements before submitting their applications to provide the international services at issue here.

- * The IRCs argued that the Graphnet and Telenet applications relied in large part upon the "open entry" policies, developed by the Commission for domestic specialized carriers, which were never applicable to international services, and therefore that those applications were based upon the discredited thesis that competition per se is in the public interest, Cf., F.C.C. v. RCA Communications, Inc., 346 U.S. 86 (1953); that Graphnet and Telenet had demonstrated no public need for their proposed services (as required by the FCC's regulations), inasmuch as those services were substantially identical to existing services being provided by the IRCs; that Graphnet and Telenet, which would each obtain facilities from "retail"

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The IRCs also emphasized that the Graphnet and Telenet applications to provide international services, if granted by the FCC, would give both those carriers an unfair competitive advantage over the existing IRCs, because Graphnet and Telenet proposed to retain full and complete access to their own domestic systems, while the IRCs would remain prohibited from interconnecting with affiliated domestic carriers,* or from themselves originating and delivering messages outside the gateway cities. As a result of this unequal regulatory treatment, Graphnet and Telenet would be able to offer hinterland customers a single integrated service for both domestic and international communications, while the IRCs could serve the hinterland only through interconnection with an unaffiliated domestic carrier. In such a situation, the IRCs would be at a distinct competitive disadvantage, since (a) hinterland customers would undoubtedly prefer the convenience of dealing

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communications carriers, could not obtain facilities from the Communications Satellite Corporation to offer their proposed services, as a result of the FCC's "authorized user" policy; and that each of the applicants had failed to provide proper supporting economic data for their respective applications, as required by FCC's regulations.

- * As ITT Worldcom pointed out to the FCC in its pleadings, Telenet was one of the domestic carriers which actively sought a Commission order prohibiting ITTDTTS from interconnecting with ITT Worldcom. (JA 249)

with a single integrated carrier such as Graphnet or Telenet, and (b) the IRCs would have little or no control over the quality and reliability of that portion of their hinterland service which was being provided by the unaffiliated domestic carrier.* Moreover, in the long run, the unaffiliated domestic carriers would have little incentive to provide the IRCs with the domestic interconnections which they needed, since if the Graphnet and Telenet applications were granted, the other domestic carriers might also be expected to seek FCC authorization to provide international service directly, rather than through interconnection with the IRCs.

* The competitive disadvantages of relying upon interconnection with a domestic carrier were described by RCA Globcom as follows:

"The level of flexibility to be found in an [interconnection with an unaffiliated domestic carrier] clearly is diminished by the presence of an entity which RCA Globcom cannot 'control' other than by negotiated interconnect contract provisions. More significantly, from a marketing standpoint, U.S. users with both domestic and international communications needs can turn to either Graphnet or Telenet as a single source supplier, rather than to a domestic data carrier and to RCA Globcom, either separately or via interconnection, to satisfy their data communications needs. Further, Graphnet and Telenet effectively have been granted by the Commission in the instant authorizations gateways in each one of the many U.S. cities in which they conduct domestic operations. Apart from the fact that this likely will have a direct and substantial effect upon the market feasibility issue,

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The IRCs argued that the FCC should not grant Graphnet and Telenet any such artificial competitive advantages, but should instead apply any competitive restrictions it deemed appropriate to all competitors, in an equal and even-handed manner. Thus, ITT Worldcom, in commenting on Telenet's application, made the following observations:

"Contrary to Telenet's claim, it should be a fortiori bound by the same gateway restrictions pertaining to all existing IRCs. . . . Since one independently material function of a gateway city is to permit the acceptance or delivery of overseas traffic originating or terminating in the hinterland through interconnection with a domestic carrier in that city, every hinterland point in Telenet's system where it proposes to interconnect with itself must be considered a hinterland gateway. Thus, the fundamental question becomes one of regulatory consistency-whether the Commission will adopt a rule of special favoritism allowing Telenet's academic application to go forward while other carriers are subject to the strictures of the Commission's existing gateway policy.

Prior Commission precedent is overwhelmingly against such preferential treatment for Telenet." JA 370-71 (emphasis added; footnotes omitted).

RCA Globcom responded in a similar fashion to Telenet's claim that it should be regulated less strictly than the IRCs:

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a public interest element not considered herein by the Commission, it represents a considerable competitive advantage, the effect of which cannot be over-emphasized. Individually and collectively, these unlimited Graphnet and Telenet gateways amount to an undeserved marketing advantage that the existing international carriers do not enjoy." JA 683.

"We believe this 'handicapping' approach to regulation is contrary to the often stated Commission determination that, where competition is introduced, existing carriers will be afforded an opportunity to compete fairly and fully without artificial constraint.

We firmly believe that any introduction of additional competition into the international marketplace, as the Commission apparently is predisposed to permit, should be accompanied by the relaxation of regulation over existing competitors so as not to inhibit the benefits that are intended to flow from further competition." JA 387-88 (footnotes omitted).

On January 11, 1977, the FCC released its Order, in which it decided (a) to consider the merits of the Graphnet and Telenet applications despite the failure of the two carriers to obtain operating agreements with the appropriate foreign administrations (JA 7), and (b) to grant those applications, along with the pending applications of WUI and RCA Globcom. The rationale for the FCC's decision to grant all four applications was that competition among these four carriers, and any additional carriers which the FCC might subsequently authorize to offer similar international services, would serve the public interest by promoting innovation and permitting the public to choose among a variety of new communications services. (JA 6-7)

In granting the four applications, the FCC's Order made no effort to equalize the regulatory treatment of the IRCs and the new international carriers. Instead, the FCC granted the Graphnet and Telenet applications in full, and permitted those carriers unrestricted access through their own domestic

networks to customers anywhere in the United States. The IRCs, however, remained confined to the gateways, and were not authorized to offer their new services in the hinterland, either by themselves or through interconnection with affiliated carriers.

The Order attempted to rationalize its disparate treatment of the IRCs and the new international carriers in two ways. First, although none of the parties to the administrative proceeding had seriously questioned the IRCs' claim that unequal application of the "gateway" and "interconnection" restrictions would place the IRCs at a significant competitive disadvantage, the FCC apparently weighed the competitive strengths and weaknesses of the IRCs and the new carriers, and concluded that despite the restrictions, the IRCs were "provided sufficient flexibility to offer their services in an effective manner and on highly competitive basis with services offered by such carriers as Graphnet and Telenet." (JA 8) In support of this conclusion, the Commission pointed out (a) that the restrictions placed on the IRCs did not absolutely prohibit them from participating in the competition to offer the new services in the hinterland (since they could do so by interconnecting their international facilities with those of un-

affiliated domestic carriers, such as AT&T*); and (b) that the IRCs "also have inherent advantages over Graphnet and Telenet by reason of their established standing in the international field." (JA 8) Apparently as the result of balancing such competitive advantages and disadvantages, the FCC decided against regulating the two groups of carriers in an equal manner.

As the second explanation of its disparate treatment of the IRCs, the FCC relied upon Section 222 of the Communications Act, supra, stating that any competitive disadvantage to the IRCs "derives not from our actions,...but from restrictions which Congress imposed on the IRCs," and adding that it would not refuse to authorize the services which Graphnet and Telenet proposed, "merely because a potential competitor might be restricted in the nature of his response by provisions of the Act which Congress, in its judgment, has seen fit to impose on certain entities." (JA 8) However, the FCC failed to explain why it now felt powerless to relieve the IRCs of the unequal application of the gateway restrictions, when the Commission had in the past consistently held that it had the

* The FCC's Order mischaracterized the ease with which the IRCs could obtain domestic interconnection. Neither AT&T nor Western Union presently provides domestic services which are precisely the same as those at issue here. Among the specialized domestic carriers, only ITTDTS and Tymnet, Inc. (in addition to Graphnet and Telenet) are authorized to provide such services. ITT Worldcom is, of course, prohibited from interconnecting with ITTDTS, and as discussed above, Tymnet, the only remaining carrier, may well decide to seek its own international authorization, as Graphnet and Telenet have done.

administrative discretion under Section 222 to modify those restrictions whenever the public interest led it to do so.*

Conspicuously absent from the Order (and from the FCC's subsequent Reconsideration Order) is any explanation of how the public interest will be advanced by placing competitive restrictions on the IRCs which are not equally applicable to Graphnet and Telenet. Nor does the FCC attempt to reconcile its decision to place unequal competitive restraints on the IRCs with the underlying rationale of the Order, which is the FCC's finding that competition among Graphnet, Telenet and the IRCs will serve the public interest. The FCC simply fails to explain why, if competition is good for the public, it is nevertheless appropriate to deny ITT Worldcom and the other IRCs a full and fair opportunity to compete.

On January 25, 1977, ITT Worldcom filed its Petition for Review of the FCC's Order with the Court. (Docket No. 77-4028). Shortly thereafter, RCA Globcom petitioned the FCC for reconsideration of its initial Order (JA 669), and further proceedings in this Court were stayed pending the outcome of

* See the FCC decisions cited at pp. 8-10, supra, and p. 38, infra. Elsewhere in the very Order here under review, the FCC adverted to the long-pending IRC applications to expand the number of gateways, and indicated it would proceed with its consideration of those applications.

additional administrative proceedings. On April 13, 1978, the FCC released its Reconsideration Order (JA 20), which reaffirmed the initial Order in all respects here relevant. RCA Globcom then filed its own Petition for Review with the Court (Docket No. 78-4047), which was consolidated with the Petition previously filed by ITT Worldcom.

ARGUMENT: The FCC's Decision to Permit Graphnet and Telenet to Compete with the IRCs, Without Subjecting Them to the Same Competitive Restrictions as the Present International Carriers, is an Arbitrary and Capricious Discrimination Which Has Not Been Adequately Justified By the Commission.

ITT Worldcom respectfully submits that the FCC's decision to permit Graphnet and Telenet to compete with the existing international carriers, without subjecting these new competitors to the same competitive restrictions which it had previously placed on the IRCs, is an arbitrary and capricious discrimination against the IRCs which the FCC has failed to justify.*

It is a basic requirement of administrative law (and, indeed, of due process) that an administrative agency may not

* The Court's jurisdiction to review and reverse administrative actions which are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" is set forth in Section 10(e) of the Administrative Procedure Act, 5 U.S.C. §706, reproduced in the statutory appendix herein at p. 7.

arbitrarily favor one applicant, or one category of applicants, over the other members of the industry which the agency was created to regulate. As this Court has held:

"The variety of problems dealt with make absolute consistency, perfect symmetry, impossible. And the law reflects its good sense by not exacting it. The law does not permit an agency to grant to one person the right to do that which it denies to another similarly situated. There may not be a rule for Monday, another for Tuesday, a rule for general application, but denied outright in a specific case." Marco Sales Co. v. F.T.C., 453 F.2d 1, 7 (2nd Cir. 1971) (emphasis added), quoting from Mary Carter Paint Co. v. F.T.C., 333 F.2d 654, 660 (5th Cir. 1964), rev'd. on other grds., 382 U.S. 46 (1965).

In a recent decision of the Court of Appeals for the District of Columbia, Judge Bazelon aptly stated the fundamental rule that agencies must treat all applicants fairly and equally, when he wrote that "the Rule of Law requires that agencies apply the same basic standard of conduct to all parties appearing before them." Teamsters Local Union 769 v. N.L.R.B., 532 F.2d 1385 (D.C. Cir. 1976). And see, Distrigas of Massachusetts Corporation v. F.P.C., 517 F.2d 761, 765 (1st Cir. 1975), which holds that an agency "has a duty to define and apply its policies in a minimally responsible and even-handed way."*

* To the same effect as the cases quoted above, see, e.g., Local 814, I.B.T.C.W. v. N.L.R.B., 512 F.2d 564, 567, 571-2 (D.C. Cir. 1975); Mariott In-Flite Services Div. of Mariott Corp. v. N.L.R.B., 417 F.2d 563, 565 (4th Cir. 1969), cert. den., 397 U.S. 920 (1970).

As demonstrated by the Statement of the Case, supra, the FCC's Order favors Graphnet and Telenet over the IRCs in two important respects. First, the FCC has permitted Graphnet and Telenet to provide their international services directly to customers located at any point within the United States, while the IRCs continue to be restricted to doing business within a handful of gateway cities. Secondly, the FCC has allowed Graphnet and Telenet full and unrestricted access to their domestic communications networks, permitting them to offer an integrated domestic and international service, while the IRCs continue to be prohibited from interconnecting their communications facilities with those of their affiliated domestic carriers. These disparities in the Commission treatment of the new carriers and the IRCs give Graphnet and Telenet a significant competitive advantage over the IRCs in efforts to win customers for the new international communications services which all of the carriers will be attempting to market. Such favoritism towards Graphnet and Telenet is obviously inconsistent with the principles of administrative equality established by Marco Sales and the other cases cited above.

The FCC's Order is not only inconsistent with the rule that the agency must treat all applicants equally, but is also a departure, without adequate explanation, from a number of the FCC's previously established regulatory policies. As

demonstrated above, the FCC's decision to grant the new international carriers unlimited access to their domestic networks is contrary to the FCC's prior policies of restricting international data carriers to the gateway cities, and prohibiting them from interconnecting with affiliated domestic carriers. Moreover, the FCC's refusal to modify its existing regulatory restrictions in order to permit the IRCs to compete equally with Graphnet and Telenet is inconsistent with the policies that the Commission has followed with respect to the domestic communications industry, in which the Commission has stated that it will modify existing regulations, if necessary, to permit the existing carriers to compete fairly with the new specialized carriers:

"We ... stress our objective to promote and maintain an environment within which existing and any new carriers shall have an opportunity to compete fairly and fully in the sale of specialized services. Our rate-making and regulatory policies and practices will be appropriately adapted to accomplish this objective. There is no reason to deny the public the benefits that may derive from active and vigorous participation by the Bell System and Western Union in this market, so long as their participation is not a burden upon or significantly detrimental to their other services. Thus, it is our intention to permit the existing carriers to price their competitive services in a fashion that will realistically and reasonably reflect economic advantages, if any, that are inherent in the plant and operations of those carriers. Moreover, we subscribe fully to the views of our staff, endorsed by the Department of Justice, that there should not be any 'protective umbrella'

for the new entrants or 'any artificial bolstering of operations that cannot succeed on their own merits'." Specialized Carrier, supra, 29 F.C.C. 2d at 915.*

In circumstances such as these, in which the agency has departed from its established policies and apparently favored one competitor over another, the courts have carefully reviewed the agency's decision, and affirmed the agency only if it has adequately justified its changes of policy, and has fully and fairly explained its reasons for granting one applicant that which it denies to another. The scrutiny which the courts have applied in such cases is exemplified by F.T.C. v. Crowther, 430 F.2d 510 (D.C. Cir. 1970), in which the court stated:

"The facts have that degree of parallelism which entitles both appellants and ourselves to a fuller explanation from the Commission ... as to why the [prior] approach should be jettisoned without giving credence to the charge that similar supplicants receive dissimilar dispensations." 430 F.2d at 514.**

* The Commission policy set forth above was implemented in American Telephone & Telegraph Co., 55 F.C.C. 224, 230 (1975).

** See also, N.L.R.B. v. Metroplitan Life Ins. Co., 380 U.S. 438, 442-3 (1965); Secretary of Agriculture v. United States, 347 U.S. 645, 653 (1954); Larus & Brother Co., Inc. v. F.C.C., 447 F.2d 876, 879 (4th Cir. 1971); Kodiak Airways, Inc. v. C.A.B., 447 F.2d 341, 354 (D.C. Cir. 1971); Greater Boston Television Corp. v. F.C.C., 444 F.2d 841, 852 (D.C. Cir. 1971), cert. den., 403 U.S. 923 (1971); Marine Space Enclosures, Inc. v. F.M.C., 420 F.2d 577, 585 (D.C. Cir. 1969); Melody Music, Inc. v. F.C.C., 345 F.2d 730 (D.C. Cir. 1965).

In its Order, the FCC attempted to justify its unequal treatment of the IRCs (a) by asserting that Section 222 prevented the FCC from according the IRCs equality of treatment with regard to the gateway restrictions and (b) by arguing that the competitive advantages which it was granting Graphnet and Telenet were necessary to make those new carriers viable competitors with the established IRCs. As will be demonstrated below, neither of these purported explanations adequately justifies the Commission's discriminatory treatment of the IRCs, because (a) the argument which the FCC makes from Section 222 rests on an erroneous interpretation of that statute, and (b) the FCC's desire to protect the competitive position of individual carriers, such as Graphnet and Telenet, is not a proper justification for the actions of a Commission charged by Congress with protecting public, rather than private, interests.

A. The FCC's Argument That Section 222 Requires the Commission to Treat the IRCs Differently From Graphnet and Telenet Rests on a Plainly Erroneous Interpretation of That Statute.

The principal justification which the FCC offers for its dissimilar treatment of Graphnet and Telenet and the IRCs is an explanation that, in its view, the Commission does not have the discretion to avoid such unequal treatment, because Congress, when it enacted Section 222, saw fit to

confine the IRCs, but not Graphnet and Telenet, to the gateway cities.

The Commission explains its position in the following manner:

"[W]e note that any possible competitive disadvantage which might accrue to the international telegraph carriers in this situation derives not from our actions authorizing Graphnet and Telenet to extend their service offerings, but from restrictions which Congress imposed on the international telegraph carriers. We cannot refuse to authorize services which would clearly benefit the public merely because a potential competitor might arguably be restricted in the nature of his competitive response by provisions of the Act which Congress, in its judgment, has seen fit to impose on certain entities." JA 8.

The adequacy of the FCC's justification for its failure to treat the IRCs and the new carriers equally thus depends entirely on the question of whether the Commission has properly interpreted Section 222 as a statutory bar which prevents the Commission from treating the two groups of carriers in the same way. On such questions of statutory interpretation, the courts, and not the FCC, are the final authority, for "upon the courts rests the ultimate responsibility of declaring what a statute means." Wisdom v. Norton, 507 F.2d 750, 756 (2nd Cir. 1974), quoting from Fishgold v. Sullivan Drydock & Repair Corp., 154 F.2d 785, 790 (2nd Cir. 1946) (L. Hand, J.), aff'd., 328 U.S. 275 (1946).*

* Accord, Volkswagenwerk Aktiengesellschaft v. F.M.C., 390 U.S. 261, 272 (1968); F.T.C. v. Colgate Palmolive Co., 380 U.S. 374, 385 (1965); N.L.R.B. v. Brown, 380 U.S. 278, 291 (1965); American Ship Building Co. v. N.L.R.B., 380 U.S. 300, 318 (1965).

As will be demonstrated, the FCC's interpretation of Section 222 is clearly erroneous, as a matter of law, and its decision must be set aside. It is of no consequence that the FCC might have been able to justify different treatment of the IRCs and the newer carriers as an exercise of its administrative discretion, if it had sought to explain its actions in such a way. For as the Supreme Court firmly established in S.E.C. v. Chenery Corp., 318 U.S. 80 (1943), when an agency states that its decision rests on the agency's construction of the pertinent rule of law, rather than on the application of its own administrative expertise, the agency must be reversed if its construction of the law is shown to be erroneous:

"If the action rests upon an administrative determination - an exercise of judgment in an area which Congress has entrusted to the agency - of course it must not be set aside because the reviewing court might have made a different determination were it empowered to do so. But if the action is based upon a determination of law as to which the reviewing authority of the courts does come into play, an order may not stand if the agency has misconceived the law." 318 U.S. at 94.*

* See also, N.L.R.B. v. Enterprise Ass'n. of Pipefitters, Local No. 638, 429 U.S. 507, 522 n.9 (1977); N.L.R.B. v. Columbia University, 541 F.2d 922, 932 (2nd Cir. 1976).

The facts of "Chenery I" are instructive. In Chenery, the S.E.C. had explained its decision by stating "that it was merely applying the broad equitable principles" which the

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Application of established principles of statutory construction demonstrate that Section 222 does not have the significance which the FCC's Order attributes to it, and the Order must therefore be reversed.

The starting point of statutory analysis is, of course, the language which Congress included in the statute itself.* The proviso of Section 222(a)(5) (quoted supra, p. 6), which is the statutory origin of the "gateway city" concept, does not expressly prohibit the FCC from authorizing expansion of the IRCs' activities beyond their gateways. On

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agency felt had been established by prior judicial precedents. 318 U.S. at 87. The Supreme Court held that the S.E.C. had misinterpreted the applicable doctrines of equity jurisprudence, and that the agency's action was therefore not, as the agency had supposed, required by law. 318 U.S. at 90, 93. The Court reversed the S.E.C., even though the Court expressly recognized that the agency might have reached the same result in the exercise of its administrative discretion and expertise, 318 U.S. at 92, because administrative actions must be reviewed solely on the basis of the grounds stated in the agency's order, and where the only reason given for the agency's action is an interpretation of law which is shown to be erroneous, the agency has not, as Chenery I holds, provided the courts and the parties with an adequate explanation for its actions.

* See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976); United States v. Oregon, 366 U.S. 643, 648 (1961); Packard Motor Car Co. v. N.L.R.B., 330 U.S. 485 492 (1947); United States v. American Trucking Associations, Inc., 310 U.S. 534, 543-44 (1940).

its face, Section 222(a)(5) does not restrict the IRCs in any way, but rather protects the IRCs from any implication that their gateway activities were to be restricted by the legislation authorizing Western Union's merger with Postal. In short, the "plain meaning" of Section 222 does not support the FCC's argument that it is prohibited by that statute from granting the IRCs an equal opportunity to compete with Graphnet and Telenet.

Turning to other familiar tests of statutory interpretation, there is nothing in the statutory purpose of Section 222,* nor in its legislative history,** which supports the argument that Section 222(a)(5) was intended to restrict the IRCs' ability to compete with companies such as Graphnet and Telenet in the hinterland. Although the legislative history does not clearly indicate Congress' reasons for

* Among the Supreme Court cases applying a "statutory purpose" test of statutory construction are: United States v. Bornstein, 423 U.S. 303, 310 (1976); Kokoszka v. Belford, 417 U.S. 642, 650 (1974); National Woodwork Manufacturers Ass'n. v. N.L.R.B., 386 U.S. 612, 619 (1967); United States v. American Trucking Ass'ns., Inc., *supra*, 310 U.S. at 543.

** Recent Supreme Court cases looking to legislative history as a guide to statutory interpretation include Train v. Colorado Public Interest Research Group, Inc., 426 U.S. 1, 9-10 (1976); Cass v. United States, 417 U.S. 72, 77-79 (1974); Tidewater Oil Co. v. United States, 409 U.S. 151, 157 (1972).

including the "gateway" proviso in Section 222(a)(5)*, the purpose of the Section was clearly to protect the IRCs, and preserve their competitive vitality, despite the prospective monopolization of the domestic telegraph industry by Western Union. See, Western Union International, Inc. v. F.C.C., supra, 544 F.2d at 90. Since the purpose of Section 222 was to protect the IRCs, rather than to restrict them, the FCC's

* The legislative history fails to provide a cogent explanation of Congress' reasons for including the proviso in Section 222. The proviso first appears in an early Senate version of the bill which ultimately became Section 222, S. 2598, 77th Cong., 2d Sess. (1942); however, the accompanying report of the Senate Interstate Commerce Committee gives no indication of the reasons for its inclusion. S. Rep. 1490, 77th Cong., 2nd Sess. (1942). After the Senate approved its version of the bill, the House of Representatives passed a closely-similar substitute, from which the proviso was "omitted as unnecessary" because, in the House's view, the bill "contains no provisions that would prevent international companies from carrying on the operations referred to in the ... proviso." H. Rep. 69, 78th Cong., 1st Sess. (1943), at p. 6. The Conference Committee, which was appointed to reconcile the House and Senate versions, later restored the proviso to the bill as it was ultimately approved by both houses. The only explanation for this action, as set forth in the Conference Committee report, was that "it was felt desirable to include this proviso, in order clearly to permit carriers to continue the operations referred to, because of the requirement" that Western Union divest itself of its international operations after its merger with Postal. H. Rep. 142, 78th Cong., 1st Sess. (1943), at p. 10. The Conference Report fails to explain, however, why it was felt that a divestiture requirement which was, on its face, applicable only to Western Union might somehow be read as a limitation on the IRCs' domestic operations, nor is there any readily-apparent logical explanation of how the divestiture clause could be so construed.

efforts to give the gateway proviso of Section 222(a)(5) a strained and expansive reading at odds with its "plain meaning" is not necessary to obtain the legislative objective of Section 222, and is, to the contrary, inconsistent with the statutory purpose of that Section.

In the circumstances of this case, the most telling argument against the Order's construction of Section 222 is the FCC's long-standing and consistent contrary interpretation of the statute.* Although the FCC has rarely seen fit to permit the IRCs to increase the number of their gateways, or to expand their activities in the hinterland,** the FCC has never suggested that it lacked statutory authority to do so, and has in fact consistently stated that it had the administrative discretion to grant the IRCs' requests for expanded operating authority, if it found that it was in the public interest to do so. For example, in the "Free Direct Access" case, supra, the Commission observed:

* See, e.g., United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 858 n. 25 (1975); Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 426 (1972); Western Union International, Inc. v. F.C.C., supra, 544 F. 2d at 91. These cases also hold that the courts should show none of their customary deference to the agency's construction of its governing statute where, as here, the FCC's present statutory interpretation conflicts with its prior rulings.

** However, as noted previously, p. 7, supra, the FCC has, despite its restrictive gateway policies, permitted several minor expansions of the IRCs' gateway activities since Section 222 was enacted in 1943.

"From the language of section 222(a)(5), it is clear that Congress did not intend to restrict the IRC's for all time to their present gateways, but it is equally clear that it was left to the Commission to determine the extent of their operations on the mainland. To accomplish its intent, Congress gave the Commission in this section the duty to approve gateways and the power to regulate the IRC's gateway operations." 40 F.C.C. 2d at 1086-87.

The Commission expressed similar views in another recent case, when it stated:

"[Section 222(a)(5)], which permits the IRCs to accept and deliver international telegraph messages in the cities which constitute gateways approved by the Commission, does not by its terms preclude the Commission from authorizing new gateways for public message telegraph service, in addition to those gateways then authorized, as the public interest requires. Even more clearly, the statute does not preclude authorization of new gateways for other services of the IRCs." International Record Carriers' Communications, supra, 54 F.C.C. 2d at 532-33.

In keeping with the policies quoted above, the FCC has not rejected the IRCs' pending applications to increase the number of gateways as beyond its authority to grant, but has instead accepted those applications for filing and further investigation which will presumably permit it to determine, in the exercise of its administrative expertise, whether an increase in the number of gateway cities would serve the public interest. Similarly, in its orders prohibiting the IRCs from interconnecting with affiliated domestic carriers, the FCC never suggested that the Commission could not have permitted such interconnection had it found it appropriate. To the contrary, the FCC clearly indicated that the restrictions it

was placing on the IRCs were adopted as an exercise of the FCC's discretion, and the agency expressly stated that it might reconsider its actions at a subsequent time if circumstances warranted.

In short, when the FCC adopted its Order, it was not bound by statute to give Graphnet and Telenet a competitive advantage over the IRCs. The FCC had the discretion, if it had wished, to permit the IRCs to compete with the new carriers in the hinterland to offer the new international services which the Commission was authorizing.* Alternatively, the Commission had the discretion to place Graphnet and Telenet under competitive restrictions similar to those applicable to the IRCs, by requiring separate incorporation of their international networks, by limiting their international operations to the gateway cities, and by prohibiting interconnection of their domestic and international networks.** The differences in the FCC's treatment of the IRCs and the new carriers cannot be

* The FCC could have achieved this result either (1) by permitting the IRCs to interconnect with the appropriate affiliated carriers, or (2) by declining to apply the traditional gateway restrictions to the new international services, thereby permitting the IRCs themselves to serve the hinterland directly.

** The FCC could have implemented these restrictions by granting Graphnet and Telenet the international authority they requested subject to their agreement to accept the conditions described above. See, RCA Global Communications, supra, 56 F.C.C.2d at 665-673.

explained, as the FCC sought to explain them, as the inevitable result of the provisions of Section 222. Under the teaching of S.E.C. v. Chenery, supra, the FCC's Order therefore must fall for lack of adequate justification.*

-
- * As demonstrated above, the FCC erred when it held that Section 222 denied it authority to permit the IRCs to compete on an equal basis outside the gateway cities. However, even if the FCC's restrictive interpretation of Section 222 were correct, it would not justify the Commission's discriminatory treatment of the IRCs, since the FCC has failed to explain why the restrictions that it believes are mandated by Section 222 should not be equally applicable to the international operation of Graphnet and Telenet, which are both offering services virtually identical to the IRCs and therefore should, presumably, be equally subject to the statute.

The only explanation in the FCC's Order for its failure to apply the restrictions it finds in Section 222 to Graphnet and Telenet is contained in a footnote, which states that those carriers do not meet the statutory definition of an international carrier because they do not yet obtain the major portion of their revenues from their international operations. (JA 8, n. 7) However, if the FCC had required the new carriers to incorporate their international and domestic facilities separately (as it had done with the IRCs), the new carriers' international subsidiaries would necessarily receive all of their revenue from international operations, and fall within the statutory definition. Moreover, the FCC's refusal to treat the international aspects of the new carriers' operations as a separate international carrier has absurd implications. In the FCC's view, Graphnet and Telenet will not become international carriers until, through their success in the international market, their international revenues exceed their domestic revenues; however, when that magical point is reached, they will automatically become "international carriers" under Section 222 and, as a reward for their competitive success, they will be required to cease international business immediately, except in the gateway cities. The possibility of such an illogical result further illustrates that the Commission has given Section 222 an implausible reading.

B. The FCC May Not Properly Justify Its Unequal Treatment of the I.R.C.s By Relying Upon the Purported Necessity of Protecting Graphnet and Telenet From Competition.

Aside from the FCC's erroneous reliance upon Section 222, discussed above, the only other possible explanation which can be discerned from the Order for the FCC's different treatment of the IRCs and the new carriers, is the FCC's apparent belief that the unequal restrictions which it has placed on the IRCs are necessary to protect the new entrants, Graphnet and Telenet, from the "inherent advantages" which the IRCs would otherwise have in the competition among the carriers. (JA 8) As will be demonstrated below, the FCC's concern for the competitive status of particular carriers is not an appropriate concern for an agency whose determinations must be measured against a "public interest" standard.

The underlying theme of the FCC's Order is that permitting Graphnet and Telenet to compete with the existing international carriers will result in benefits to the public which uses the various carriers' competing services. The FCC may, of course, authorize new international communications carriers and, upon making the proper findings, may rely upon the beneficial effects of competition to further the public interest. See, e.g., Washington Utilities & Transportation Commission v. F.C.C., 513 F.2d 1142 (9th Cir. 1975), cert. den., 423 U.S. 836 (1975). The FCC's Order, however, does not

merely permit Graphnet and Telenet to compete on an equal basis with the existing international carriers in the expectation that such competition will benefit the public. Instead, the FCC attempts to go further, and provide Graphnet and Telenet with significant competitive advantages over the IRCs. In doing so, the Commission committed error of the sort which led another Court of Appeals to reverse the FCC in Hawaiian Telephone Company v. F.C.C., 498 F.2d 771 (D.C. Cir. 1974):

"Looming large in the Commission's rationale, indeed, undeniably the key factor in its decision, is competition. Competition as a factor might have some relevance to the FCC decision, if competition had been shown to be of benefit to the public on the communication routes in question. Yet it is all too embarrassingly apparent that the Commission has been thinking about competition, not in terms primarily as to its benefit to the public, but specifically with the objective of equalizing competition among competitors.

"This is not the objective or role assigned by law to the Federal Communications Commission. As a result of focusing first on competitors, next on competition, and then on the public interest, the FCC has given scant attention to the question of public convenience and necessity, and therefore has not met its statutorily imposed duty." 498 F.2d at 775-76 (emphasis added in part).

Here, as in Hawaiian Telephone, the purported rationale for the FCC's decision is that the public interest will be served by encouraging competition in the international communications industry. As indicated above, the Commission may, if it makes the appropriate findings, rely upon the recognized advantages of a competitive market to further the

public good.* However, if the Commission chooses to employ competitive principles to supplement its own regulatory efforts, it is totally inconsistent, as Hawaiian Telephone points out, for the Commission to attempt to influence the results of that competition by giving one competitor an artificial advantage over another.

If competition is to achieve a public good, it is because the potential customers for the competing services of Graphnet, Telenet, and the IRCs are free to choose whichever carrier provides the best service at the best price, thereby encouraging the carriers to be innovative and responsive to the customer's needs. The Commission's decision to favor Graphnet and Telenet over the IRCs is irreconcilably inconsistent with the Order's purported decision to rely upon the advantages of a competitive market structure, since it stifles the customer's

* The economic theory justifying competition in a partially-regulated industry is, of course, the same as that favoring competition in the economy generally. As this Court recently observed:

"There is no reason why competition in the communications industry should be expected to have a different result than in the motor car, department store, electrical devices, radio and similar industries. All seek to attract business by offering a superior product for a reasonable price. Such practices are in the public interest in that the public should benefit therefrom."

RCA Global Communications, Inc. v. F.C.C., supra, opinion following remand, Slip Opinion, p. 5.

opportunity to make an unbiased choice among the carriers. If Graphnet and Telenet win customers not because their services are superior to those of the IRCs, but because the FCC has given them an artificial competitive advantage, no public good will be served, nor will any competitive incentive be created to improve the carriers' services to their customers. Only the private interests of Graphnet and Telenet will be advanced and, as Hawaiian Telephone holds, furtherance of such private competitive interests cannot justify the Order of a Commission whose administrative duty is to protect the public interest and "to make available, so far as possible, to all the people of the United States, a rapid efficient, nation-wide and world-wide wire and radio communication service." Communications Act, Section 1, 47 U.S.C. §151.

CONCLUSION

For the reasons stated above, ITT Worldcom respectfully requests that its Petition for Review be granted and the FCC's Order be reversed. In its proceeding below, the FCC decided a number of issues, most of which need not be addressed again by the Commission on remand. ITT requests only that the Court instruct the FCC to modify the various authorizations it has made, before implementation, in a way that will provide all carriers with equal opportunities to compete. The manner in which the Commission may accomplish this result should, of

course, be left to the FCC's discretion, and the Commission may decide either to lift the gateway and interconnection restriction on the IRCs, insofar as those restrictions apply to the services at issue here, or to place comparable restrictions on Graphnet and Telenet.

Dated: New York, New York
May 28, 1978

Respectfully submitted,

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STATUTORY APPENDIX

STATUTORY APPENDIX - TABLE OF CONTENTS

	<u>Page</u>
Communications Act of 1934, Section 1, 47 U.S.C. §151.....	1
Communications Act of 1934, Section 222, 47 U.S.C. §222.....	1
Administrative Procedure Act, Section 10(e), 5 U.S.C. §706.....	7

Communications Act
Section 1, 47 U.S.C. §151

§151. Purposes of chapter; Federal Communications Commission created.

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this chapter.

Communications Act of 1934,
Section 222, 47 U.S.C. §222

§222. Consolidations and mergers of telegraph carriers.

(a) Definitions.

As used in this section -

(1) The term "consolidation or merger" includes the legal consolidation or merger of two or more corporations, and the acquisition by a corporation through purchase, lease, or in any other manner, of the whole or any part of the property, securities, facilities, services, or business of any other corporation or corporations, or of the control thereof, in exchange for its own securities, or otherwise.

(2) The term "domestic telegraph carrier" means any common carrier by wire or radio, the major portion of whose traffic and revenues is derived from domestic telegraph operations; and such term includes a corporation owning or controlling any such common carrier.

(3) The term "international telegraph carrier" means any common carrier by wire or radio, the major portion of whose traffic and revenues is derived from international telegraph operations; and such terms includes a corporation owning or controlling any such common carrier.

(4) The term "consolidated or merged carrier" means any carrier by wire or radio which acquires or operates the properties and facilities unified and integrated by consolidation or merger.

(5) The term "domestic telegraph operations" includes acceptance, transmission, reception, and delivery of record communications by wire or radio which either originate or terminate at points within the continental United States, Alaska, Canada, Saint Pierre-Miquelon, Mexico, or Newfoundland and terminate or originate at points within the continental United States, Alaska, Canada, Saint Pierre-Miquelon, Mexico, or Newfoundland, and includes acceptance, transmission, reception, or delivery performed within the continental points of origin within and points of exit from, and between United States between points of entry into and points of designation within, the continental United States with respect to record communications by wire or radio which either originate or terminate outside the continental United States, Alaska, Canada, Saint Pierre-Miquelon, Mexico and Newfoundland, and also includes the transmission within the continental United States of messages which both originate and terminate outside but transit through the continental United States: Provided, That nothing in this section shall prevent international telegraph carriers from accepting and delivering international telegraph messages in the cities which constitute gateways approved by the Commission as points of entrance into or exit from the continental United States, under regulations prescribed by the Commission, and the incidental transmission or reception of the same over its own or leased lines or circuits within the continental United States.

(6) The term "international telegraph operations" includes acceptance, transmission, reception, and delivery of record communications by wire or radio which either originate or terminate at points outside the continental United States, Alaska, Canada, Saint Pierre-Miquelon, Mexico, and Newfoundland, but does not include acceptance, transmission, reception, and delivery performed within the continental United States between points of origin within and points of exit from, and between points of entry into, and points of destination within, the continental United States with respect to such communications, or the transmission within the continental United States of messages which both originate and terminate outside but transit through the continental United States.

(7) The terms "domestic telegraph properties" and "domestic telegraph facilities" means properties and facilities, respectively, used or to be used in domestic telegraph operations.

(8) The term "employee or "employees" (i) shall include any individual who is absent from active service because of furlough, illness, or leave of absence, except that there shall be no obligation upon the consolidated or merged carrier to reemploy any employee who is absent because of furlough, except in accordance with the terms of his furlough, and (ii) shall not include any employee of any carrier which is a party to a consolidation or merger pursuant to this section to the extent that he is employed in any business which such carrier continues to operate independently of the consolidation or merger.

(9) The term "representative" includes any individual or labor organization.

(10) The term "continental United States" means the District of Columbia and the States of the Union, except Hawaii.

(b) Consolidation or merger authorized; acquisition of facilities.

(1) It shall be lawful, upon application to and approval by the Commission as hereinafter provided, for any two or more domestic telegraph carriers to effect a consolidation or merger; and for any domestic telegraph

carrier, as a part of any such consolidation or merger or thereafter, to acquire all or any part of the domestic telegraph properties, domestic telegraph facilities, or domestic telegraph operations of any carrier which is not primarily a telegraph carrier: Provided, That, except as provided in paragraph (2) of this subsection, no domestic telegraph carrier shall effect a consolidation or merger with any international telegraph carrier, and no international telegraph carrier shall effect a consolidation or merger with any domestic telegraph carrier.

(2) As a part of any such consolidation or merger, or thereafter upon application to and approval by the Commission as hereinafter provided, the consolidated or merged carrier may acquire all or any part of the domestic telegraph properties, domestic telegraph facilities, or domestic telegraph operations of any international telegraph carrier.

- (c) Application to Commission; public hearings, determination of public interest; approval; divestment of international operations.

(1) Whenever any consolidation or merger is proposed under subsection (b) of this section, the telegraph carrier or telegraph carriers seeking authority therefor shall submit an application to the Commission, and thereupon the Commission shall order a public hearing to be held with respect to such application and shall give reasonable notice thereof, in writing, and an opportunity to be heard, to the Governor of each of the States in which any of the physical property involved in such proposed consolidation or merger is situated, to the Secretary of State, the Secretary of Defense, the Attorney General of the United States, representatives of employees where represented by bargaining representatives known to the Commission, and to such other persons as the Commission may deem advisable. If, after such public hearing, the Commission finds that the proposed consolidation or merger, or an amended proposal for consolidation or merger, (1) is authorized by subsection (a) of this section, (2) conforms to all other applicable provisions of this section, (3) is in the public interest, the Commission shall enter an order approving and authorizing such consolidation or merger, and thereupon any law or

laws making consolidations and mergers unlawful shall not apply to the proposed consolidation or merger. In finding whether any proposed consolidation or merger is in the public interest the Commission shall give due consideration, among other things, to the financial soundness of the carrier resulting from such consolidation or merger.

(2) Any proposed consolidation or merger of domestic telegraph carriers shall provide for the divestment of the international telegraph operations theretofore carried on by any party to the consolidation or merger, within a reasonable time to be fixed by the Commission, after the consideration for the property to be divested is found by the Commission to be commensurate with its value, and as soon as the legal obligations, if any, of the carrier to be so divested will permit. The Commission shall require at the time of the approval of such consolidation or merger that any such party exercise due diligence in bringing about such divestment as promptly as it reasonably can.

(d) Alien ownership of capital stock.

* * *

(e) Distribution of telegraph traffic among international carriers; contiguous foreign country defined; intervention of Commission; international and domestic operations construed.

(1) In the case of any consolidation or merger of telegraph carriers pursuant to this section, the consolidated or merged carrier shall, except as provided in paragraph (2) of this subsection, distribute among the international telegraph carriers, telegraph traffic by wire or radio destined to points without the continental United States, and divide the charges for such traffic, in accordance with such just, reasonable, and equitable formula in the public interest as the interested carriers shall agree upon and the Commission shall approve: Provided, however, That in case the interested carriers should fail to agree upon a formula which the Commission approves as above provided, the Commission, after due notice and hearing, shall prescribe in its order approving and authorizing the proposed consolidation or merger a formula which it finds will be just, reasonable, equitable, and in the public interest, will be, so far as is

consistent with the public interest in accordance with the existing contractual rights of the carriers, and will effectuate the purposes of this subsection.

(2) In the case of any consolidation or merger pursuant to this section of telegraph carriers which immediately prior to such consolidation or merger, interchanged traffic with telegraph carriers in a contiguous foreign country, the consolidated or merged carrier shall distribute among such foreign telegraph carriers, telegraph traffic by wire or radio destined to points in such contiguous foreign country and shall divide the charges therefor, in accordance with such just, reasonable, and equitable formula in the public interest as the interested carriers shall agree upon and the Commission shall approve: Provided, however, That in case the interested carriers should fail to agree upon a formula which the Commission approves as above provided, the Commission, after due notice and hearing, shall prescribe in its order approving and authorizing the proposed consolidation or merger a formula which it finds will be just, reasonable, equitable, and in the public interest, will be, so far as is consistent with the public interest, in accordance with the existing contractual rights of the carriers, and will effectuate the purposes of this subsection. As used in this paragraph, the term "contiguous foreign country" means Canada, Mexico, or Newfoundland.

(3) Whenever, upon a complaint or upon its own initiative, an after a full hearing, the Commission finds that any such distribution of telegraph traffic among telegraph carriers, or any such division of charges for such traffic, which is being made or which is proposed to be made, is or will be unjust, unreasonable, or inequitable, or not in the public interest, the Commission shall by order prescribe the distribution of such telegraph traffic, or the division of charges therefor, which will be just, reasonable, equitable, and in the public interest, and will be, so far as is consistent with the public interest, in accordance with the existing contractual rights of the carriers.

(4) For the purposes of this subsection, the international telegraph operations of any domestic telegraph carrier shall be considered to be the operations of an independent international telegraph carrier, and the domestic telegraph operations of any international carrier shall be considered to be the operations of an independent domestic telegraph carrier.

(f) Protection of employees.

* * *

Administrative Procedure Act
Section 10(e), 5 U.S.C. §706

§706. Scope of review.

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall-

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be-

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

CERTIFICATE OF SERVICE

1. I am an attorney associated with the firm of LeBoeuf, Lamb, Leiby & MacRae, attorneys for petitioner, ITT World Communications Inc.

2. I hereby certify that the attached Brief has been served on the attorneys of record for all parties to this proceeding in the following manner.

3. At my direction, copies were delivered today by hand to the following persons at the listed addresses:

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4. I have this day served the Brief on all remaining parties to this proceeding by mailing true copies thereof, first class mail, postage prepaid, to the following persons at the listed addresses:

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Att.: C. Grey Pash, Esq.

4. I have this day served the Joint Appendix on all remaining parties to this proceeding by mailing true copies thereof, first class mail, postage prepaid, to the following persons at the listed addresses:

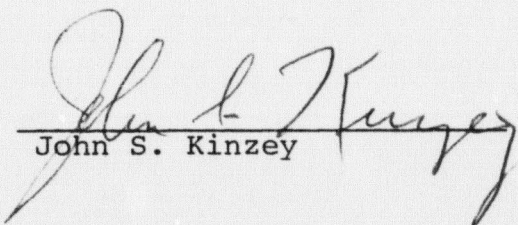
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